COMMENTARY
Insight SMA | 4th Quarter 2019

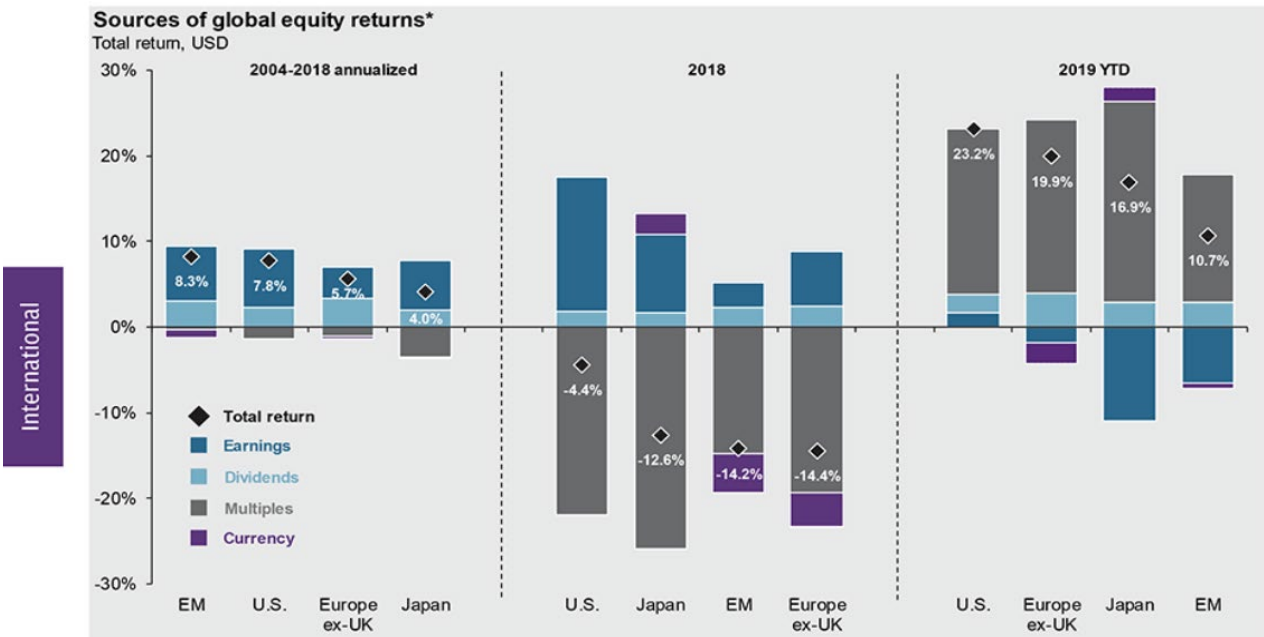
The philosophy underpinning the Sterling Capital Insight portfolio is that few investors should possess better insight into the future prospects of a company than its executives and board members. Just as lower valuations generally tilt the odds of investing success in investors' favor, so does insider buying, too. That thesis has been validated by academic studies from researchers at Harvard, Yale, Stanford, and the University of Michigan, which independently found that corporate insiders have achieved superior risk-adjusted returns. A peer-reviewed article published in the November 2011 edition of the International Review of Economics and Finance further validated those findings, concluding that "Insider actions have positive predictive power for future returns. […] Managers know more about their companies than any outsider, including Wall Street analysts, and as such, investors could benefit from observing the behavior of insiders."

The majority of the Insight portfolio is invested in companies in which there has been recent insider buying activity; we also retain the flexibility to own companies in which insiders own a substantial (5%+) stake of the company, whereby their incentives already are well-aligned with ours as shareholders, but where it would be less likely to expect insiders to take a further stake via additional purchases. Such flexibility also enables the portfolio to invest in overseas companies that trade on U.S. exchanges, where insider buying is not reported in real-time.

Performance

In the fourth quarter of 2019, the Insight portfolio rose 7.2% (before fees) and 6.8% (after fees), compared to 9.0% for the Russell 1000 index, 7.1% for the S&P Midcap 400 index and 9.1% for the S&P 500. For the full year of 2019, Insight logged a 34.8% (before fees) and 33.2% (after fees) gain, compared to 31.4% for the Russell 1000 index, 26.2% for the S&P Midcap 400 index, and 31.5% for the S&P 500. This marked the third straight year in which Insight outperformed its benchmarks on a gross basis.

U.S. stocks turned in their best showing since 2013, fueled by low interest rates, trade resolutions, and rising valuation multiples. But as a group, the S&P 500 generated negligible earnings growth in 2019, representing a mirror image of 2018, when stocks declined even as earnings grew significantly.



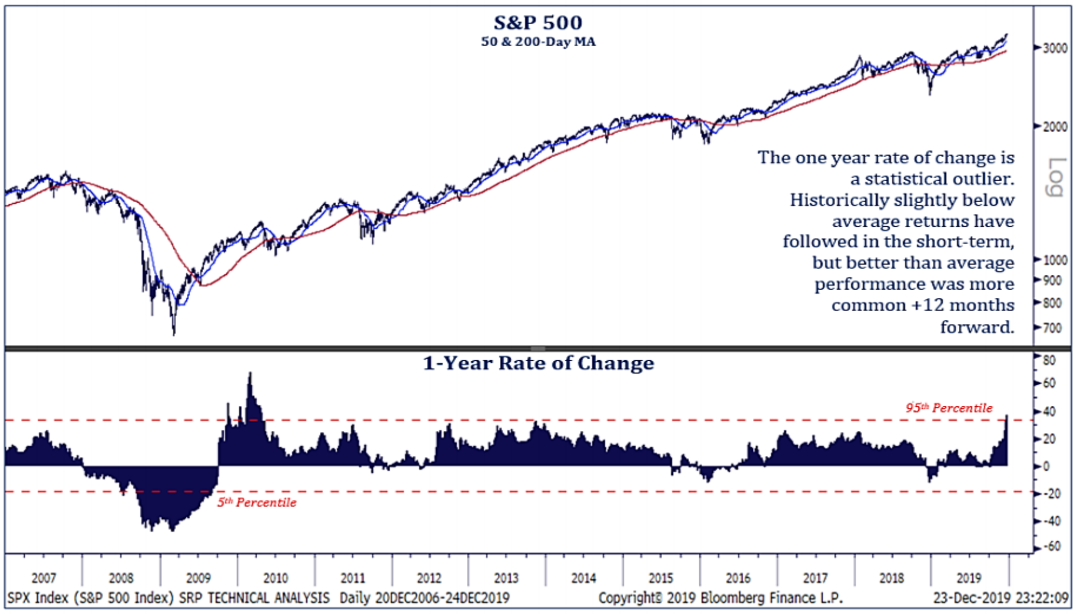
Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management.
All return values are MSCI Gross Index (official) data, except the U.S., which is the S&P 500. *Multiple expansion is based on the forward P/E ratio, and EPS growth outlook is based on NTMA earnings estimates. Chart is for illustrative purposes only. Past performance is not indicative of future results.

Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management

"Markets had a pretty big wish list, and we got everything we wanted," UBS Chief Economist Kevin Russell said. "The only problem is the market was expecting to get all of those things" – referring to a trade deal with China, a more accommodative Federal Reserve, and similar monetary support from the European Central Bank.

The 2010-2019 period marked the first decade since the Civil War in which the U.S. economy didn't experience a recession – and that's notable relative to where sentiment was a year ago, when stocks sold off -19.9% (just missing the technical definition of a "bear market"), and when the yield curve inverted (causing investors to worry about a potential recession that didn't occur). In other words, it paid to be greedy when others were fearful.

95th PERCENTILE EVENT SINCE THE LOW



Source: Strategas

For those who let politics intersect with their investing, the composition of Congress and the White House was exactly the same in 2019 (when stocks returned 30%+) as it was in the fourth quarter of 2018 (when the S&P 500 endured a -13.5% decline). Arguably, the biggest change between 2018 and 2019 was the direction of Fed monetary policy. According to Deutsche Bank, "Since the Fed started buying T-bills in October [2019], a 1% increase in the Fed balance sheet has been associated with a 0.9% increase in the S&P 500." Don't fight the Fed?

Winners and Losers

We have a confession to make: We made plenty of mistakes in 2019. We added to some stocks that haven't yet contributed meaningfully (**Constellation Brands**), trimmed some stocks that kept rising (**Microsoft**), bought some stocks that declined (**Occidental Petroleum, Ulta Beauty**), and sold a number of stocks that kept rising (**AT&T**, **Danaher**, **Thermo Fisher**, and **Ecolab**). It's a timely reminder that perfection is not necessary to achieve satisfactory results in this endeavor.

With the S&P 500 turning in its strongest year since 2013, stocks that outright declined in value for the full year were relatively few and far between. Our portfolio owned three losers in 2019, those being **Occidental Petroleum** (-14%), **Ulta Beauty** (-10%), and **Schlumberger** (-4%). While OXY was the worst stock in the portfolio, Insight's biggest negative contributor was cash, which subtracted about three percentage points from portfolio returns. *Mea culpa*. Six gainers increased in value by more than 50%, those being **Ball** (+74%), **Kansas City Southern** (+62%), **Genpact** (+58%), **Microsoft** (+58%), **IHSMarkit** (+57%), and **Aramark** (+52%).

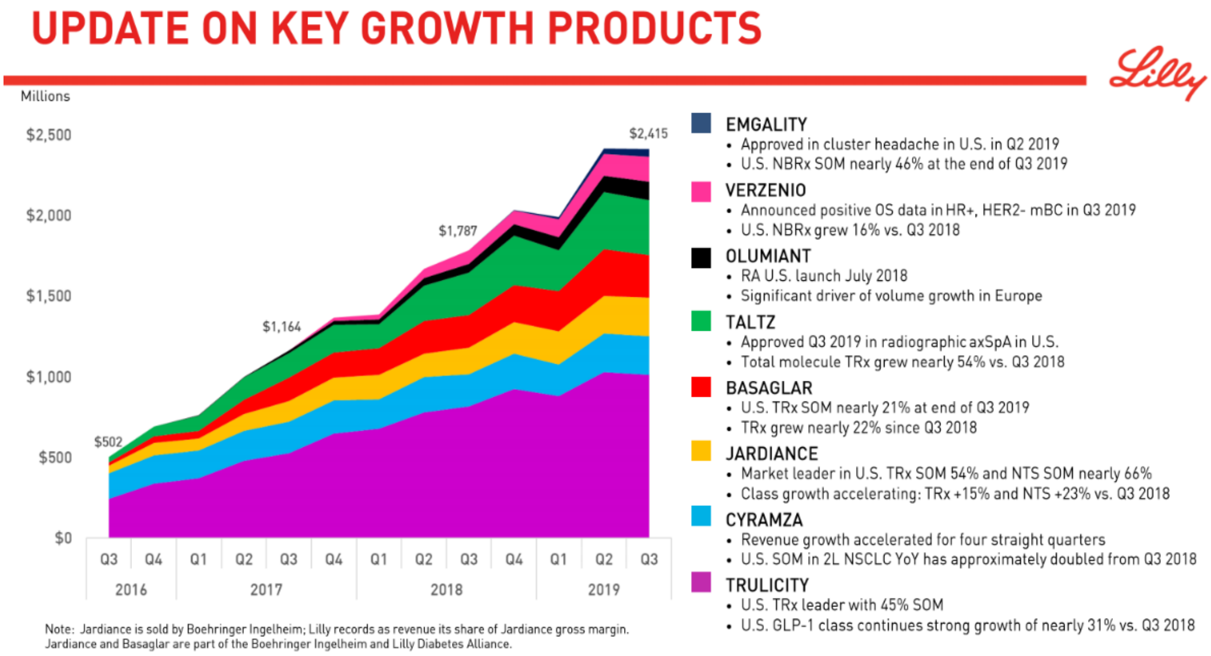
In the fourth quarter, six of our stocks declined in value, with only **Ulta** (-10%) falling by a double-digit percentage. The remaining stocks in the portfolio increased in value, with 14 of them rising by a double-digit percentage. Gainers were paced by **United Health's** 36% quarterly surge. With some political risks receding while earnings continued to come through, health insurers turned in their largest quarterly gain since 1994, according to Bloomberg.

Purchases and Sales

What do we view as a stronger signal than insider buying? We'll apologize in advance for what's essentially a trick question. When *multiple* insiders buy in rapid succession, we consider that a sign that knowledgeable company officials independently have arrived at a similar conclusion: that the stock's valuation, company fundamentals, and the timing are aligning to present a compelling opportunity. We mention this because each of the stocks we purchased in the fourth quarter had multiple insider buyers.

Known for its broad portfolio of diabetes and cancer medicines, pharmaceutical giant **Eli Lilly** likely needs little introduction. We observed five separate insider purchases in November, which included the company's CEO and CFO. Amid skepticism about whether the company would continue to endorse its longstanding profit margin goals for 2020, we viewed the five insider signals as a strong indicator that the company was unlikely to disappoint. We also viewed valuation as providing a cushion; at the time of our purchase, shares traded near the low end of their five-year range, around parity with the S&P 500 versus a five-year average closer to a 19% premium. In other words, we saw an above-average company trading at a merely average valuation.

Lo and behold, when the company provided 2020 guidance in December, its range exceeded prevailing Street targets, sending the stock higher. Morgan Stanley observes that even if Lilly continues to produce sizable profit margin improvement through 2023, Lilly "would still be toward the low end of the global pharma group in 2023" – suggesting a still long runway of opportunity. For its part, JPMorgan views Lilly "as one of the best-positioned names in the Major Pharma group, with a healthy base business, a growing portfolio of new launches and next-generation assets, as well as a significant margin expansion story. This should drive ~6-8% top line growth and mid-teens annual EPS growth through much of the next decade."

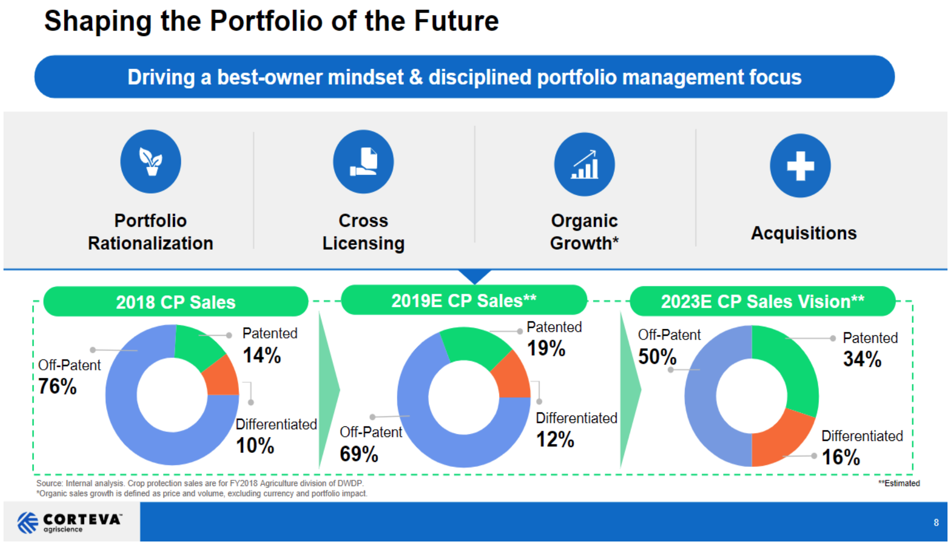


Source: Eli Lilly

In November, we added agricultural leader **Corteva** to the portfolio. Spun out as a newly independent company, Corteva represents the seed and herbicide businesses of its former parents Dow and DuPont. Rewinding the clock just a month, investors were tied in knots about a potentially worsening trade war with China. But insiders seemed to take a different view. As was the case with Lilly, multiple Corteva insiders including the CEO and CFO purchased shares in November, and as InsiderScore observed, the four Corteva buyers "all have a long history with CTVA's predecessor companies. CEO James Collins was only a seller during his tenure as a DuPont executive," so in our view, his buying behavior is notable.

Time will tell whether the subsequent "phase one" trade deal between China and the United States proves meaningful, but Corteva indicated trade issues had a "dampening effect" on its business in 2019. The company also will be lapping about $250 million of headwinds associated with flooding and other weather issues that impaired its 2019 performance, and another $200 million of foreign-exchange headwinds. So, comparisons in 2020 ought to be relatively more benign.

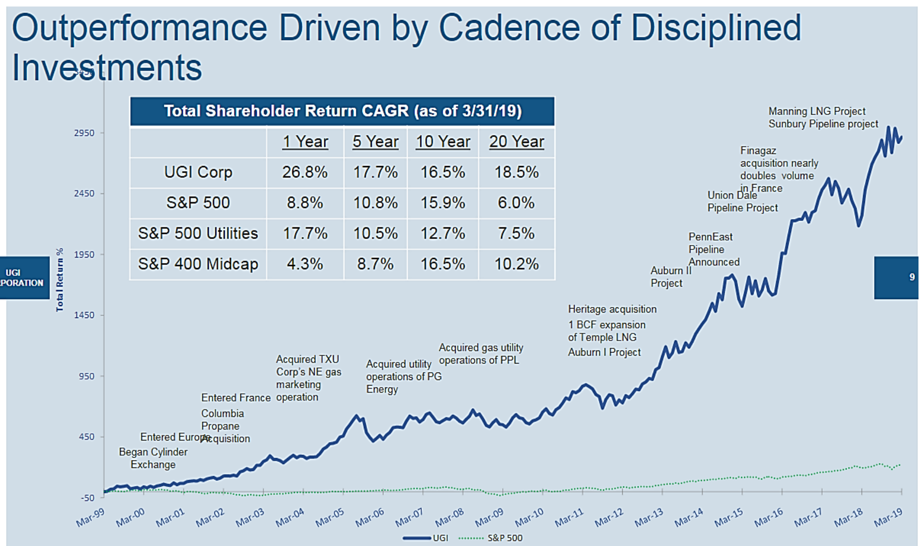
We're particularly attracted to Corteva's rising share of patented and differentiated products, which helps both sales and profit margins. Such products have helped raise farmers' corn yields nearly 7-fold in the past 80 years, with Corteva expecting to launch a steady stream of similar yield-enhancing products over the next several years. As EVP Rajan Gajaria recently told investors, "R&D is the lifeblood of our company; new products is how we win over time."



Source: Corteva

Meanwhile, at the time of our purchase, Corteva traded at 14x earnings, a discount to the S&P 500, despite expectations for earnings to grow at an above-average pace for the foreseeable future. While we wait to harvest today's proverbial sapling, Corteva supplies a 2%+ dividend yield, and has begun repurchasing shares.

Also in November, we added utility **UGI** to the portfolio. The company is a gas and electricity distributor in Pennsylvania, and has grown at a healthy clip through sensible acquisitions over the past several decades. In 2020, the company will be lapping unusually warm winter weather from the prior year (which clipped 2019 sales and earnings), while recent acquisitions Amerigas and Columbia Midstream start to bear fruit.



Source: UGI

We believe the company has decent line-of-sight to continued double-digit growth, while at the time of our purchase, its stock traded at its widest discount to the S&P 500 in a decade. Two insiders purchased shares leading up to our entry, with InsiderScore flagging both buyers for previously well-timed purchases. The combined $6.5 million these two insiders purchased in the fourth quarter of 2019 marked the largest dollar quarterly buying at the company in at least 10 years. While we await fundamental and valuation improvement, the stock pays a 3% dividend, and the company has raised its dividend 32 years in a row.

We sold **Schwab** in the midst of news reports that it would acquire rival Ameritrade. Industry consolidation didn't surprise us, but the timing did. We thought Schwab already had its hands full, with the pending acquisition of USAA's brokerage platform. Schwab also had been stepping up its capital return program, reducing shares outstanding by 4% year-over-year, while growing its dividend 70% year-over-year. Now, to facilitate the Ameritrade acquisition, Schwab will turn around and issue shares, and we presume dividend growth will slow considerably. Additionally, as the industry's largest player, we didn't see Schwab as necessarily the most in need of additional scale. Meanwhile, falling bond yields throughout 2019 have pressured Schwab's interest income, causing earnings results to drop. Finally, Schwab's own decision to cut commission pricing to zero erased another 7% of highly profitable revenue. So, with the stock up amid enthusiasm for the Ameritrade deal, despite lower earnings, we viewed the risk/reward as less favorable.

Similar to competitor Ball, which we sold in the third quarter, we exited **Crown** amid heightened expectations for aluminum beverage packaging alongside multiple insider sales. We also sold protective packaging company **Sealed Air**, in part reflecting our lack of enthusiasm for an immediately dilutive acquisition that re-levers the company and halts share buybacks for the foreseeable future. Plastic packaging also seems to face incremental sustainability headwinds, which we believe may be more secular than temporal.

During the quarter, we bought and sold **Ulta Beauty**. We viewed the retreat in the company's valuation and sentiment as potentially attractive relative to the company's long-term growth track record. Two insider buyers, including the CEO, put the stock on our wish list, and ordinarily we'd give an investment a longer leash, but we lost conviction after learning one of the company's key merchants – described as "one of the key architects of Ulta Beauty's success in prestige" cosmetics departed suddenly to "contemplate her next move" (according to trade publication WWD). We also drew a negative competitive read-through from Target's comments that its recent store remodels helped drive "amazing strength in beauty and cosmetics." Finally, we were surprised that as Ulta's stock continued to dip, no further insider buying took place.

Company Developments

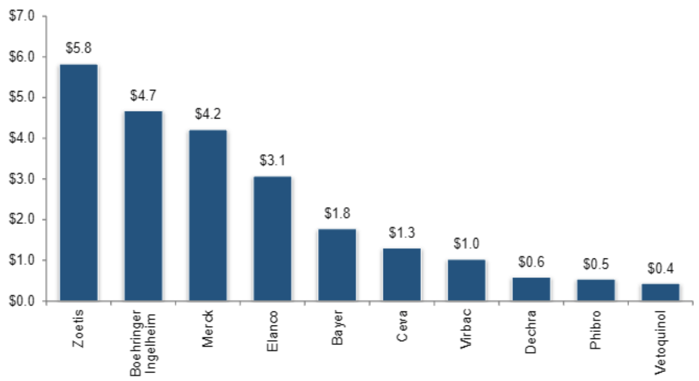
During the quarter, four of our companies increased their dividends, each by a double-digit percentage: **M&T Bank** +10%, **Kansas City Southern** +11%, **Eli Lilly** 15%, and **Visa** 20%.

Kansas City Southern also authorized a new $2 billion buyback program, repurchasing $550 million against it immediately. As Wolfe Research said, "KSU is becoming less capital intensive," as its "precision scheduled railroading" initiatives continue to bear fruit. As a result, Wolfe says, "KSU is the only rail where we remain above consensus" for 2020. Among other companies announcing incremental share buybacks, **Chubb** upped its buyback authority by $1.5 billion, while **IHSMarkit** added a $2.5 billion repurchase program and will begin paying its first-ever dividend in early 2020.

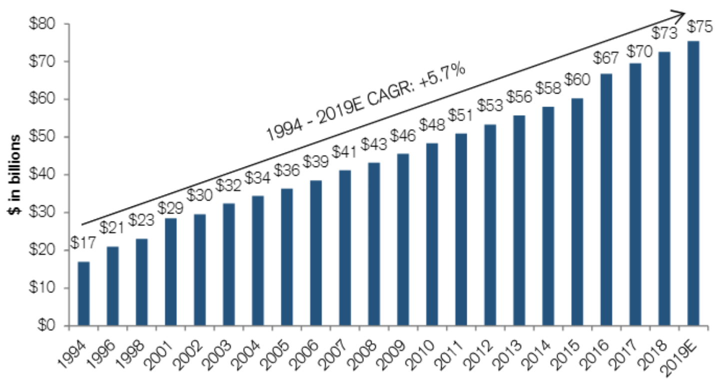
Aramark has a new CEO, John Zillmer, a veteran of the company. He brings more recent experience as CEO of Allied Waste and Univar. Along with Mr. Zillmer, Aramark has five new board members, including former Heinz, McDonald's, and Yum Brands executives, as activist investor Mantle Ridge has made quick work in reshaping Aramark's upper ranks. We like that shortly after being named CEO, Mr. Zillmer promptly purchased $1.5 million of Aramark stock personally. As well, Baird Research highlights that "new short- and long-term [incentive compensation] metrics [place] greater emphasis on top-line growth (relative to EPS/FCF) with a new total shareholder return modifier/kicker." In other words, Mr. Zillmer will get rewarded asymmetrically if and as he helps increase shareholder value.

It's also worth calling out additional insider buying at **Elanco**. Following five separate insider purchases in the third quarter, we saw two more buyers in the fourth quarter. Perhaps their views are similar to Merrill Lynch, which recently upgraded its rating of Elanco, citing "significant upside as revenue and EBITDA growth reaccelerates bolstered by contribution from Bayer Animal Health. The out-year upside from the combined company is too significant for us to ignore. We think it is now appropriate to look ahead to 2021 and beyond. Given the valuation discount that Elanco has traded at since the deal announcement, we see upside without excessive multiple expansion." The rebuilding of global herds, following a particularly disruptive 2019 in which African swine flu ravaged pig populations, should help the livestock side of Elanco's business On the companion animal side of the business, we're attracted to Elanco + Bayer becoming a strong #2 player in a very steady, GDP plus growth rate, as shown in the accompanying charts.

Top Global Animal Health Pharmaceutical Companies



US Pet Expenditures 1994-2019E, $ in billions

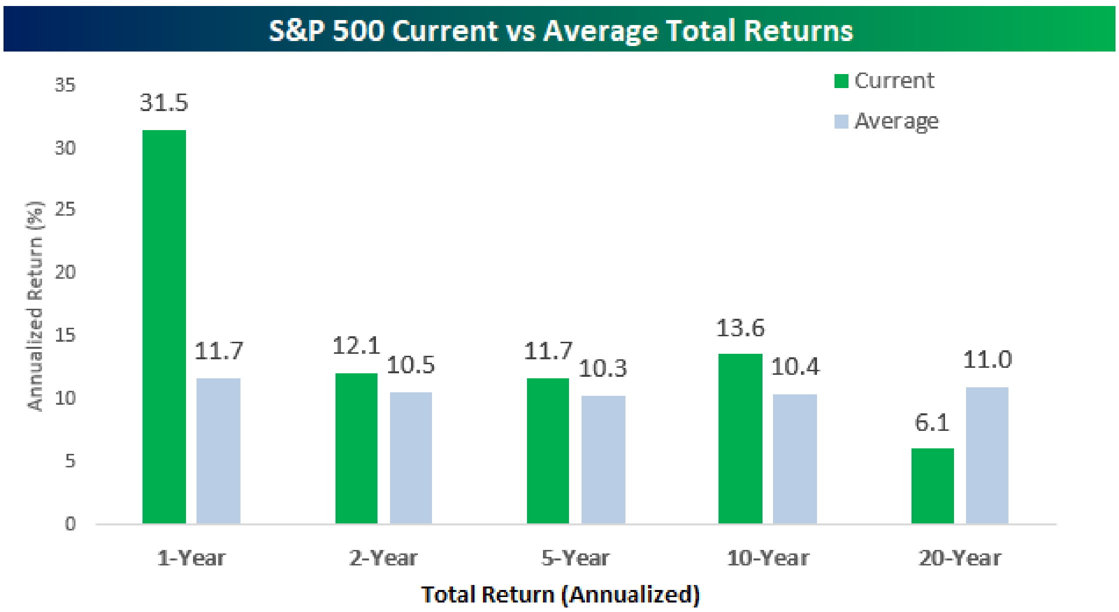


*Source: Company Data, APPA, Credit Suisse estimates. *Includes functional nutritionals*

General Dynamics won a $22 billion contract to deliver a fifth block of Virginia class submarines. Cowen Research says, "the Navy is reviewing its fleet requirements to better match the Defense Department's strategic refocus on China as the U.S.' primary military rival. This review entails taking account of China's hypersonic threat to our large naval platforms and increased need to project power in the Pacific. We see GD as a potential net beneficiary." For its part, Stifel Research said that 2020 is shaping up to be an important inflection year for defense contractors, such as General Dynamics, pointing to an accelerating change in year-over-year defense outlays.

Conclusion

After 2019's robust gains, the market's 2- and 5-year performance is now much closer to its long-term average.

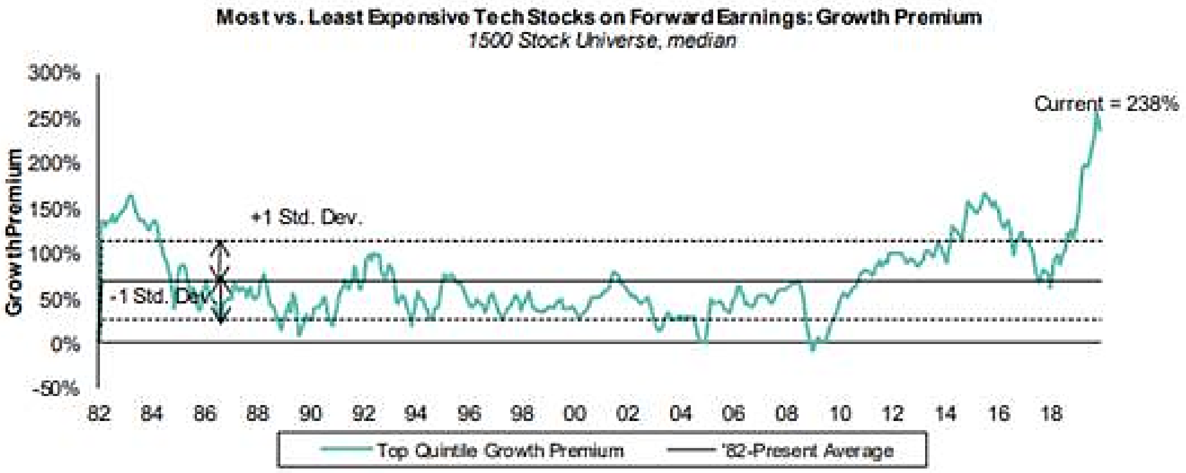


Source: Bespoke

It seems like a decidedly non-bold prediction to expect 2020 returns will be neither as robust nor as linear as they were in 2019. This past year saw zero "corrections" (defined as a 10%+ decline), with the maximum drawdown for the year checking in at less than 7% (way back in May). It also seems like a non-bold prediction to expect returns to be less broad than they were in 2019, a year in which all 11 sectors generated double-digit percentage returns, and 10 of 11 saw 20%+ returns (Energy was the laggard at +11.8%, while Technology led with a sizzling 50.3% return).

Watch what they do, not what they say. While Technology was the best performing sector in 2019, its valuation lifted toward the highest level in 15 years. Among Technology companies, the highest-growth quintile are trading at a particularly outsized premium to the lowest-growth quintile, as shown in the accompanying chart.

EXHIBIT 19: **Large Cap Technology Median Growth Premium of the Most vs. Least Expensive Tech Stocks**



Source: Bernstein Quant Team (Larson). As of 12.11.2019.

If one area of the market happens to be overpriced, we have flexibility to look elsewhere. Maybe it's just a coincidence, but amid high valuations and new-fangled definitions of profitability, none of Insight's last ten purchases came from the Technology sector (three of the last ten purchases were Healthcare companies, with the other seven purchases spread across seven different sectors). In fact, Technology happens to represent Insight's largest underweight heading into 2020. To be sure, we would happily invest capital in companies – in the Technology sector or elsewhere – that meet our criteria. We are sector agnostic in pursuit of the best relative risk-reward opportunities.

We view investing alongside corporate insiders as somewhat akin to taking an open-book test. In the quarters and years ahead, our plan is to continue doing more of the same – seeking companies that meet our objective criteria around valuation, growth, leverage, and returns – where insiders are providing a peek at the answer key.

Warmest wishes for a happy, healthy, and prosperous New Year. As always, we greatly appreciate your confidence in us and interest in our thoughts.

Adam Bergman, CFA®
Portfolio Manager

Performance is preliminary and is annualized for periods longer than one year. Net of fees performance returns are presented net of the investment management fees and trading expenses. Gross of fees performance returns reflect the deduction of trading costs; a client's return will be reduced by the management fees and other expenses it may incur. Investment management fees are described in Sterling's Form ADV 2A. Performance reflects the reinvestment of interest income and dividends and realized capital gains. The performance presented represents past performance and is no guarantee of future results. Performance is compared to an index, however, the volatility of an index varies greatly and investments cannot be made directly in an index. Market conditions vary from year to year and can result in a decline in market value due to material market or economic conditions. The Performance is considered Supplemental Information to the Composite Disclosure Presentation which is attached.

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Sterling Capital Management – Insight SMA Composite

August 31, 2011 – December 31, 2018

Description: *Consists of all discretionary separately managed wrap Insight portfolios. Sterling's Insight equity portfolios invest primarily in companies where there has been recent insider buying activity; we also retain the flexibility to own companies in which insiders own a substantial stake.*

Year	Total Return "Pure" Gross of Fees	Total Return Net of Fees	No. of Portfolios	Composite Assets End of Period ($MM)	Percent of Firm Assets	Total Firm Assets ($MM)	Composite Dispersion (%)	Russell 1000	Composite 3-yr St Dev (%)	Benchmark 3-yr St Dev (%)
2018	-4.10	-5.26	51	16	0.0	56,889	0.38	-4.78	10.79	10.95
2017	25.37	23.78	57	18	0.0	55,908	0.35	21.69	9.18	9.97
2016	10.39	8.88	146	33	0.1	51,603	0.30	12.05	9.92	10.69
2015	5.14	3.69	116	29	0.1	51,155	0.25	0.92	9.35	10.48
2014	7.41	5.88	134	29	0.1	47,540	0.24	13.24	9.42	9.12
2013	28.48	26.64	121	27	0.1	45,638	0.24	33.11		
2012	17.74	16.17	74	14	0.3	4,422	0.08	16.42		
2011 (Inception 8/31/11)	4.86	4.62	2	0	0.0	3,932		3.50		
Annualized Since Inception	12.53	11.05						12.55		

Sterling Capital Management LLC claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Sterling Capital Management LLC has been independently verified for the periods 01/01/01 to 12/31/17. The verification report(s) is/are available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

Notes:

1. Sterling Capital Management LLC (SCM) is a registered investment advisor with the SEC. Registration does not imply a certain level of skill or training. Sterling manages a variety of equity, fixed income and balanced assets. Prior to January 2001, Sterling was a wholly owned subsidiary of United Asset Management (UAM). In January 2001, Sterling Capital Management LLC purchased all the assets and business of Sterling Capital Management Company from UAM to become an employee owned firm. There were no changes in personnel. In April 2005, BB&T Corporation purchased a majority equity ownership stake in Sterling Capital Management LLC. There were no changes in personnel. In October 2010, the management group of Sterling Capital entered into an agreement with BB&T Corporation that reduced and restructured management's interest in Sterling Capital Management. Additionally, BB&T Asset Management merged into Sterling Capital Management. There were no material changes in personnel. In January 2013, CHOICE Asset Management firm merged into Sterling Capital Management. There were no changes in personnel. "Percent of Firm Assets" and "Total Firm Assets" prior to 2013 are for CHOICE Asset Management. In August 2015, 8 new employees joined Sterling Capital management via Stratton Management Company following the close of BB&T's purchase of Susquehanna Bancshares. There were no changes to personnel.
2. Adam B. Bergman, CFA, has managed the portfolio since inception. No alterations of composites, as presented herein, have occurred due to changes in personnel or other reasons at any time.
3. Inception date of composite: August 31, 2011. Creation date: August 31, 2011. The appropriate index is the Russell 1000 Index which measures the performance of the largest 1,000 US companies, representing over 90% of the investable US market. The index is reconstituted annually. Total return includes price appreciation/depreciation and income as a percent of the original investment. A complete list of all of SCM's composites and their descriptions is available upon request. Policies for valuing portfolios, calculating performance and preparing compliant presentations are available upon request.
4. Performance reflects reinvested interest income and dividends and realized and unrealized capital gains and losses. All portfolios are valued monthly as of calendar month-end and utilize trade-date and accrued income accounting. Valuations and performance are reported in US dollars. Portfolio returns are calculated monthly using the Modified Dietz method. Portfolios are revalued for cash flows greater than 10%. Composite returns are calculated by weighting the individual portfolio returns using beginning of period market value plus weighted cash flows. Periodic time weighted returns are geometrically linked. Returns are not calculated net of non-reclaimable withholding taxes due to immaterial dollar amounts.
5. "Pure" gross of fees returns do not reflect the deduction of any fees including trading costs. The net of fee return reflects the actual SMA fee of the individual account. The SMA fee includes all charges for trading costs, portfolio management, custody and other administrative fees. Sterling's actual management fees are 32 basis points annually.
6. The annual composite dispersion presented is measured by an asset-weighted standard deviation calculation method of all portfolios in the composite for the entire year. It is not meaningful when there are less than six portfolios in the composite for the entire year. The three year annualized standard deviation measures the variability of the composite and benchmark returns over the preceding 36 month period. It is not required to be presented for annual periods prior to 2011 or when a full three years of composite performance is not yet available.
7. The performance presented represents past performance and is no guarantee of future results. Stock market conditions vary from year to year and can result in a decline in market value due to material market or economic conditions.